

**Letter of Findings: 08-0702**  
**Corporate Income Tax**  
**For the 2004 and 2005 Tax Years**

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**ISSUES**

**I. Corporate Income Tax—Imposition.**

**Authority:** IC § 6-3-2-2; IC § 6-8.1-5-1.

Taxpayer protests the imposition of adjusted gross income tax.

**II. Tax Administration—Penalty.**

**Authority:** IC § 6-8.1-10-2.1; [45 IAC 15-11-2](#).

Taxpayer protests the imposition of penalties.

**STATEMENT OF FACTS**

Taxpayer is a multi-state company consisting of a parent-holding corporation and several subsidiaries that engage in the business of operating retail stores and renting property in a number of states, including Indiana. Taxpayer filed a consolidated Indiana adjusted gross income tax return including its subsidiaries that had activities in Indiana for the tax year 2004 and 2005 tax years.

After auditing the 2004 and 2005 tax years, the Indiana Department of Revenue (Department) concluded that Taxpayer's Indiana adjusted gross income as filed did not fairly reflect its Indiana source income. The Department found that the level of Taxpayer's intercompany transactions significantly distorted Taxpayer's reported Indiana adjusted gross income.

As a result of that audit examination, the Department made a number of adjustments, which increased Taxpayer's tax liabilities and assessed additional adjusted gross income tax, penalties, and interest. Taxpayer protested the tax assessment. An administrative hearing was held, and this Letter of Findings results. Further facts will be supplied as necessary.

**I. Corporate Income Tax—Imposition.**

**DISCUSSION**

Pursuant to IC § 6-8.1-5-1(c), all tax assessments are presumed to be accurate, and the taxpayer bears the burden of proving that an assessment is incorrect.

Taxpayer asserts that the Department's assessments violated a prior settlement agreement that was executed in January of 2005 (hereafter "Agreement") and were based upon unsupported findings that the Taxpayer's filing method lead to distortion and that the Department's filing method lead to a fairer reflection of Indiana source income.

**A. Combined Returns.**

Taxpayer maintains that the Department's assessment for the 2004 and 2005 tax years resulting from calculating Taxpayer's Indiana adjusted gross income under the unitary combined-filing method eliminating its net operating loss carry forwards from the 2001, 2002, and 2003 tax years and increasing its adjusted gross income for the 2005 tax year violates the Agreement.

The Agreement states as follows;

Through the fiscal year [2004], the Department will not impose adjusted gross income tax or supplemental net income tax on [Non-Indiana Corp.], or for adjusted gross income tax or supplemental net income tax purposes will not combine or consolidate [Non-Indiana Corp.] with its other affiliates. For fiscal years thereafter (i.e. subsequent to the fiscal year [2004]) in which royalty payments are made by [subsidiary] to [Non-Indiana Corp.] are not being deducted in arriving at subsidiary's net income for adjusted gross income tax purposes... the Department will continue its agreement... as long as there is no material change in the corporate structure, in the intercompany payments, in applicable Indiana law or in the nature of [Non-Indiana Corp.'s] business activities in the state of Indiana.

The Department's audit report concludes that the assessment—based upon a unitary combined-filing method for the 2001, 2002, 2003, and 2005 tax years—does not violate the Agreement because the Taxpayer's structure and intercompany payments have changed.

In the hearing, the Taxpayer provided additional documents in support of Taxpayer's protest. Those documents included copies of the Taxpayer's profit and loss statements, federal forms 1065 and 1120, the intercompany-payment agreements between the Taxpayer's related subsidiaries, and the Taxpayer's organizational charts. Taxpayer offered these documents in support of its assertions that, for the years at issue, the Taxpayer's corporate structure had not materially changed and that the intercompany payments remained the same. Upon further review of these documents coupled with the Taxpayer's statements during the hearing, the

Department cannot find any data or evidence to contradict the Taxpayer's assertions.

Based upon Taxpayer's additional information as reviewed by the Department, the Taxpayer has met its burden of supporting its argument that the Taxpayer's corporate structure had not materially changed and that the Taxpayer's intercompany payments had not changed. Taxpayer has met its statutory burden of demonstrating that the Department's decision to calculate Taxpayer's income on a unitary-combined basis does not comply with the Agreement.

**B. Exclusion of the Partnership.**

Under the authority of IC § 6-3-2-2(l) and (m), the Department calculated the Taxpayer's Indiana adjusted gross income for the 2004 tax year by excluding one of Taxpayer's partnerships from the Taxpayer's consolidated filing. The partnership that was removed controlled most of the operations taking place in two other states and had little Indiana activity outside of its corporate partner's Indiana activities.

Taxpayer maintains that the Department's findings that the Taxpayer's filing method resulted in distortion and that the Department's filing method resulted in a fairer reflection of Indiana source income were not supported—or were based upon misleading or incorrect statements made in the report. Additionally, Taxpayer suggests that when the correct adjustments are used to remove the partnership from the return, a loss actually results—further supporting Taxpayer's original filings and the fact that the Indiana stores operate at a loss.

In the hearing, the Taxpayer provided additional documents in support of Taxpayer's protest. Those documents included copies of the Taxpayer's profit and loss statements, federal forms 1065 and 1120, and the intercompany-payment agreements between the Taxpayer's related subsidiaries. The Taxpayer offered these documents in support of its assertions that, for the years at issue, the Indiana retail operations were not as profitable as the retail operations in other states resulting in the lower Indiana adjusted gross income for the years at issue. Upon further review of these documents coupled with the Taxpayer's statements during the hearing, the Department cannot find any data or evidence to contradict the Taxpayer's assertions.

Based upon Taxpayer's additional information as reviewed by the Department, the Taxpayer has met its burden of supporting its argument that the exclusion of its partnership does not fairly reflect Taxpayer's income derived from Indiana sources. Taxpayer has met its statutory burden of demonstrating that the Department's decision to exclude the partnership from the consolidated filing is incorrect.

**FINDING**

Taxpayer's protest is sustained.

**II. Tax Administration—Penalty.**

**DISCUSSION**

Taxpayer protests the imposition of the ten (10) percent negligence penalties for the tax years in question. The Department refers to IC § 6-8.1-10-2.1(a)(3), which provides "if a person... incurs, upon examination by the department, a deficiency that is due to negligence... the person is subject to a penalty."

The Department also refers to [45 IAC 15-11-2\(b\)](#), which states:

Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

The Department may waive a negligence penalty as provided in [45 IAC 15-11-2\(c\)](#), as follows:

The department shall waive the negligence penalty imposed under [IC 6-8.1-10-1](#) if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.

In this case, since Taxpayer has established that it does not owe the proposed assessments as discussed in Issue I, Taxpayer has established that there was not a failure to pay deficiencies and accordingly that it exercised ordinary business care, as required by [45 IAC 15-11-2\(c\)](#).

**FINDING**

Taxpayer's protest to the imposition of penalty is sustained.

**CONCLUSION**

Taxpayer's protests to the imposition of tax and to the imposition of penalty are sustained.

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